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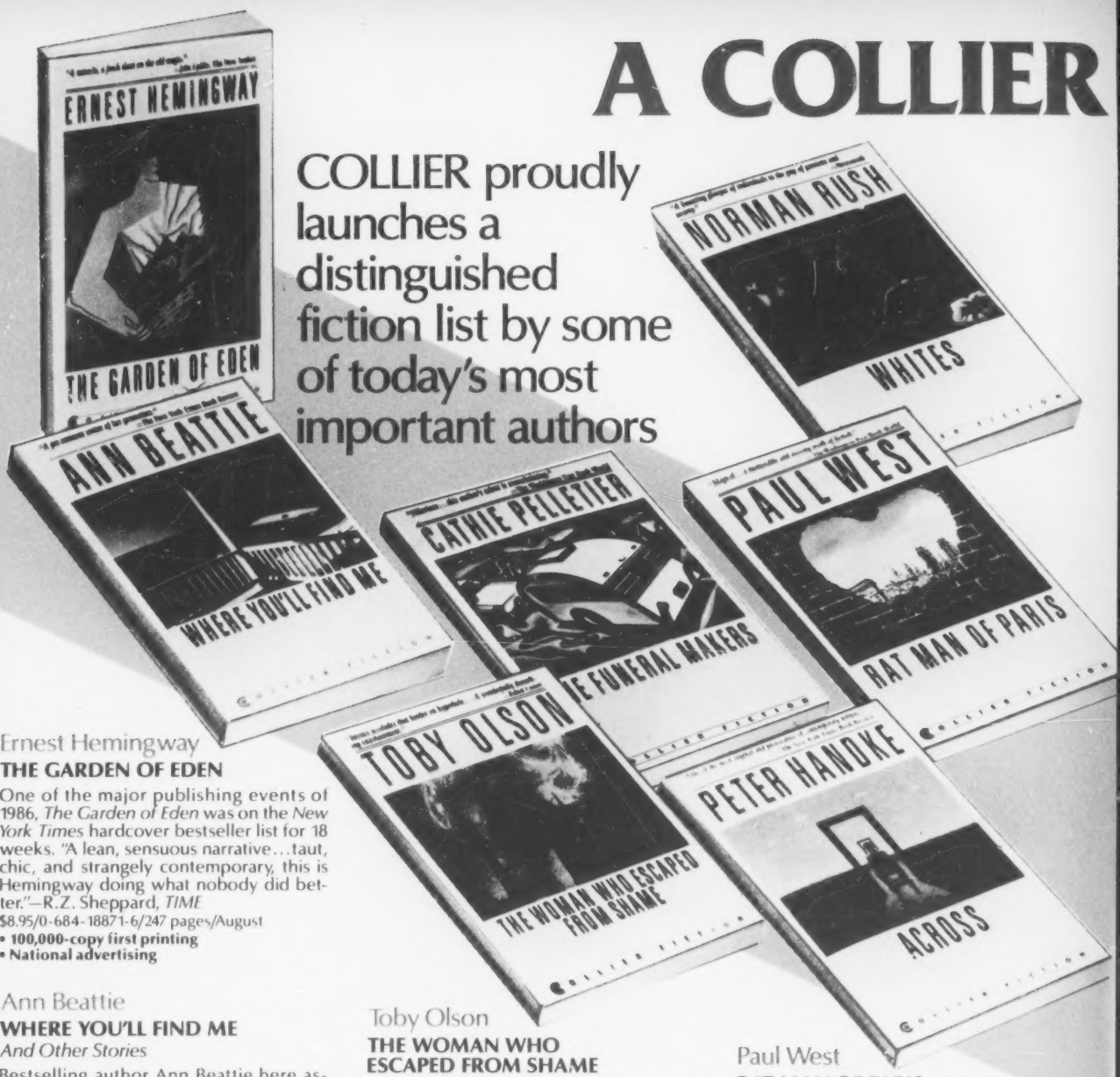

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Book Sales Rise 5.8% to $10.5 Billion in 1986

Book sales in 1986 totaled $10,454,500,000, an increase of only 5.8% over 1985, according to estimates by the Association of American Publishers. In the previous year, 1985 sales rose 8.3% over 1984.

Audiovisual and Other Media showed the greatest increase: 36.5% for College and 28.6% for "Other."

Books registering the greatest increase were in the Business and Other Professional category: 18.6%. Next came Juvenile books, hardbound showing a 15.7% increase and paperbound showing 12.4%

Sales of rack-size Mass Market Paperbacks were nearly flat: 0.1%.

Association of American Publishers
Estimated Book Industry Sales, 1972, 1977, 1982, 1985, 1986

Millions of Dollars

	1972	1977	1982		1985		1986			
	$	$	$	% chg from 77	$	% chg from 82	$	% chg from 85	% chg from 82	% chg from 77
Trade (Total)	444.8	887.2	1355.5	52.8	1988.7	46.7	2095.5	5.4	54.6	136.2
Adult Hardbound	251.5	501.3	671.6	34.3	995.9	48.3	1025.8	3.0	52.7	104.6
Adult Paperbound*	82.4	223.7	452.0	102.1	656.6	45.3	683.5	4.1	51.2	205.5
Juvenile Hardbound	106.5	136.1	180.3	32.5	250.7	39.0	290.1	15.7	60.9	113.2
Juvenile Paperbound	4.4	26.1	51.5	97.3	85.5	66.0	96.1	12.4	86.6	268.2
Religious (Total)	117.5	250.6	390.0	55.6	455.0	16.7	475.5	4.5	21.9	89.7
Bibles, Testaments, Hymnals & Prayerbooks	61.6	116.3	163.7	40.8	174.7	6.7	182.9	4.7	11.7	57.3
Other Religious	55.9	134.3	226.2	68.4	280.3	23.9	292.6	4.4	29.4	117.9
Professional (Total)	381.0	698.2	1230.5	76.2	1561.0	26.9	1722.5	10.3	40.0	146.7
Technical & Scientific	131.8	249.3	431.4	73.0	561.7	30.2	579.1	3.1	34.2	132.3
Business & Other Professional	192.2	286.3	530.6	85.3	630.3	18.8	747.5	18.6	40.9	161.1
Medical	57.0	162.6	268.5	65.1	369.0	37.4	395.9	7.3	47.4	143.5
Book Clubs	240.5	406.7	590.0	45.1	686.7	16.4	698.4	1.7	18.4	71.7
Mail Order Publications	198.9	396.4	604.6	52.5	603.7	-0.1	620.6	2.8	2.6	56.6
Mass Market Paperback Rack-Sized	250.0	487.7	665.5	36.5	761.5	14.4	762.3	0.1	14.5	56.3
University Presses	41.4	56.1	122.9	119.1	147.8	20.3	160.5	8.6	30.6	186.1
Elementary & Secondary Text	497.6	755.9	1051.5	39.1	1481.1	40.9	1604.0	8.3	52.5	112.2
College Text **	375.3	649.7	1142.4	75.8	1325.0	16.0	1409.8	6.4	23.4	117.0
Standardized Tests	26.5	44.6	69.7	56.3	92.2	32.3	96.6	4.8	38.6	116.6
Subscription Reference	278.9	294.4	396.6	34.7	486.6	22.7	501.2	3.0	26.4	70.2
AV & Other Media (Total)	116.2	151.3	148.0	-2.2	199.5	34.8	211.1	5.8	42.6	39.5
Elhi	101.2	131.4	130.1	-1.0	173.9	33.7	177.4	2.0	36.4	35.0
College	9.2	11.6	7.9	-31.9	9.9	25.3	13.5	36.5	70.9	16.4
Other	5.8	8.3	10.0	20.5	15.7	57.0	20.2	28.6	102.0	143.4
Other Sales	49.2	63.4	77.1	21.6	89.7	16.3	96.5	7.6	25.2	52.2
Total	3017.8	5142.2	7844.3	52.5	9878.5	25.9	10454.5	5.8	33.3	103.3

* Includes Non-Rack-Sized sales by Mass Market Publishers of $113.5 million in 1982; $170.2 million in 1985, and $172.9 million in 1986.

**The Higher Eucation Division of AAP has requested the Statistical Service Center to conduct an independent survey of college publishers. For 1986, this survey of 44 college publishers, which in the opinion of the Higher Education Division Statistics Committee represent the majority of known College publishers, reported sales of $1155.7 million.

Anatomy of an Acquisition

Behind the scenes in the recent major changes of ownership in publishing are many stories—scary, sorrowful, triumphant; these are some of them

BY GAYLE FELDMAN

Passion. Intrigue. Greed. High drama. These are the stuff of which novels and book publishing mergers are made. The U.S. publishing business over the past decade has moved in the direction of extremes. As in so many other sectors of American industry, the quickening pulse of mergers and acquisitions in the book world has resulted in some very large and many very small companies, while the medium-size publishing house, rather like the middle class on the island of Manhattan, has become something of a rare and endangered species.

Anybody sitting down to write an anatomy textbook of the American publishing body corporate these days would have to start by compiling a new vocabulary of leveraged buy-outs and golden parachutes, poison pills and white knights, economies of scale and fiduciary responsibilities. And detailing surgical procedures for exploring the state of health of consolidations—such as Gulf + Western/Prentice Hall, Macmillan/Scribners and Atheneum, Bertelsmann/Doubleday, Penguin/NAL and News America/Harper & Row—doesn't just involve clean diagnostic tools like profit and loss accounts, five-year plans, balance sheets and bottom lines. The messy, visceral, unquantifiable emotional and psychological networks of desires and passions and appetites play an equally significant role in the entire process.

The tales of recent concentration in the book publishing industry are often not pleasant ones, but sprinkled amongst the horror stories are some happy endings too, and both should be examined. Why have the recent acquisitions taken place and will the spiral continue for the foreseeable future? Has merger activity of the past few years differed significantly from the previous big consolidation wave of the '60s? What are the nitty-gritty steps in an acquisition, and who are the players? What happens before the deed is done, and what comes into force once the ink has started to dry? What, finally, does all this wheeling and dealing mean for the books that are being produced and the people—authors, editors, publishing personnel of all sorts and readers—who create and use them?

No anatomy of the buying and selling that is going on these days can put everything under the microscope, and this article doesn't pretend to do so. And, understandably, many of those who participated in the process decided that discretion was the better part of valor and opted for an "off the record" presence, which shouldn't discount the importance of what they have to say—for the current wave of consolidation in American book publishing concerns everyone active in the business.

The Merger Scorecard

Apart from investment banks that produce internal records of transactions, the two main sources for listings of mergers and acquisitions in the book publishing industry are Bowker's *Literary Market Place* and *BP Report*. Because the pace of buying and selling has quickened, and because one large sale often spawns several smaller transactions shortly thereafter (for example, Doubleday was sold to Bertelsmann at the end of last year and Bertelsmann has now sold off the Laidlaw subsidiary to Macmillan), no listing can be com-

'International Thomson recognized the special culture of our company [Warren, Gorham & Lamont] and the profitability it produced, and we were overwhelmed by their offer. In retrospect, it was a big mistake to sell'

TED CROSS

pletely comprehensive. Also, the announcement of a deal and its consummation sometimes straddle two years and get lost to the record keepers along the way.

Therefore, the 1987 *LMP* lists 66 American book publishing company transactions as having taken place between 1984 and 1986, of which 29 took place in 1986. *BP*, in its annual surveys, lists 31 transactions in 1984, 41 in 1985 and 24 in 1986. Despite the discrepancy between the two tallies, it is clear that many publishing companies have changed hands in the past three years. Although a number of these transactions take place within the $3 million to $5 million bracket or even less, the past few years have seen some very large sales indeed.

The tables in the article are courtesy of investment bankers Brown Brothers Harriman, and the first shows a selected list of nine major transactions during 1985–87, including the amount paid for the company and its price/revenue ratio. The second chart ranks the leading publishers of trade, college and elhi books, with the asterisks indicating that they have been active purchasers of companies or lists in that field during the past three years. Over half of the companies in each category have grown through acquisitions during that period and their rankings have been affected accordingly. The third table lists market data for selected companies and shows how the feverish activity of the past five years has caused their price/earnings ratios to climb on average from 8.2 to 29.1 times earnings. That is a remarkable increase for any business sector.

Taking the Public Route

Publishing entities are bought and sold for a number of reasons. Historically, companies have been sold because their founders or family owners felt they needed to do so for estate or tax purposes. Bennett Cerf and Donald Klopfer went public and then sold Random House in the 1960s to RCA because they felt that the death of one partner would leave the other and the families concerned too dangerously exposed. Estate worries also came into Walter Minton's decision to sell Putnam, the firm his family had controlled since 1932, to MCA in 1976. Minton explained, "Like so many people in publishing, I didn't know how to work with borrowed money. One of the main reasons for consolidations at that time was that a number of houses like Putnam had been in debt in the 1930s and took years getting back into the black. Once you get out of debt, you don't want to go back in. A lot of companies, faced with no heir apparent or the inability to transfer ownership without putting an excessive tax burden on the inheritor, opt to sell. Like us, fairly large houses usually start by making the firm a public company, which we did in the early 1970s."

That turned out to be problematic, he said, "because returns on invested capital are really very high in the book publishing business—higher than in a lot of other industries in the U.S.—but people who buy shares look primarily at stock prices and in trade publishing the price-earnings ratio used to be low. Companies like Simon & Schuster, Random House and my own found that when they first went public, the share prices increased, but shortly afterward they fell to below their starting figures. I decided I wanted to park the company—I didn't like debt, I didn't have an inheritor, and I saw the need for substantial investment to grow.

"I controlled close to half of the shares and some key people in the company had shares, so over 50% were 'closely held.' We nearly had deals with Harcourt Brace Jovanovich and then with ITT, but the deal that was consummated in the end was with MCA. They owned Universal Pictures and TV, record companies and other properties and didn't own any book publishers. They had great ideas about 'synergies' between books, films and TV, and that was a factor influencing a lot of book company purchases at that time, although I don't think much synergism really exists, and you don't find people making that claim anymore." (In-

TABLE I

SELECTED RECENT BOOK PUBLISHING TRANSACTIONS ($millions)

Announcement Date	Acquirer/Acquiree	Total Consideration (a)	Price/ Revenues
4/85	Gulf + Western/Ginn & Co.	$100.0	1.3x (b)
5/85	Int'l. Thomson Organisation Gale Research Co.	62.5	2.0
6/85	Reed Holdings Inc./ R.R. Bowker	90.0	2.2
12/85	Holtzbrinck/W.H. Freeman	26.5 (b)	1.8 (b)
10/86	Bertelsmann/ Doubleday & Co. Inc.	475.0	1.1 (b)
10/86	Time Inc./Scott, Foresman	520.0	2.6
10/86	Harcourt Brace Jovanovich/ CBS Books division	500.0	1.7
11/86	Int'l. Thomson Organisation/ Southwestern Publishing	286.4	3.0
3/87	New America Holdings Inc./ Harper & Row	338.0	1.6

(a) *Total consideration is defined as purchase price plus debt assumed*
(b) *Estimate*

Courtesy of Brown Brothers Harriman

terestingly, Rupert Murdoch's purchase of Harper & Row has over the past few months recalled synergism back from the dead.) "MCA recognized that publishing would be a potentially very profitable business to be in, and so we concluded a reverse stock merger whereby a subsidiary company was set up that merged into Putnam and that company then merged into MCA."

The One You Can't Refuse

Traditionally another reason for the sale of a book company has been the making of an offer that cannot be refused. Ted Cross, whose bid set in motion the Harper & Row sale, founded Warren, Gorham & Lamont with his two brothers about 30 years ago. They published looseleaf and professional journals and books on law, taxes and financial services.

Cross recalls that "one day, Gordon Brunton, the then managing director of the International Thomson Organisation phoned and asked if we would consider selling. I said no, but he clearly suggested there would be no harm in meeting. And that was the end. He at first offered my brothers and me not less than $60 million plus lots of British blarney and charisma. He eventually concluded the deal for $80 million, which included the sale of an affiliated company. My brothers and I had never had much capital and we never dreamed of anyone putting that kind of value on our life's work. Yes, Michael Brown (ITOL's president) assigned an excessive value to WG&L, but he knew it would be worthwhile in the end. Harper & Row, CBS and VNU had previously approached us, but all of them had thought in terms of traditional valuations—x times earnings. WG&L at that time had $25 million in sales. But over the past six years that figure has grown to about $100 million. ITOL recognized the special culture of our company and the profitability it produced, and we were overwhelmed by their offer. In retrospect, it was a big mistake to sell."

John Suhler, of the investment firm Veronis, Suhler, pointed out that not every publishing sale takes place from a basis of success or harmony. "Sometimes a company isn't doing well and needs to find a strategic partner in order to survive. Other times, if shares are in the control of a number of family members, there are disagreements among them about the future or the risk profile of the business and that initiates the sale process. Also, people see the values being assigned to similar companies in the marketplace and decide it's time to cash in. Once somebody crosses the line to sell, a real momentum builds up—when emotionally the decision has been made, the sale can happen very quickly."

The Motivations for Buying

What motivates the buyers to go on their shopping expeditions? Obviously the desire for growth plays a very large part. According to Richard Witmer, a senior manager with Brown Brothers Harriman, who has advised on 11 book publishing transactions over the past decade, "a large company that accumulates a lot of money in its core businesses has a great deal of unused debt capacity. If you're sitting on a lot of cash, which is a low return, have high tax assets and are not prudently leveraged, you are not earning the sort of return that will make your shareholders happy. Companies are compelled therefore to reinvest their cash in higher yielding properties that give them growth. The dollars involved in buying a book publishing company are generally small relative to the dollars they've accumulated. For example, if you look at Rupert Murdoch's holdings, the Harper & Row purchase, although expensive in book publishing terms, is not really all that large. I suppose it's similar to the way a Japanese insurance company might value a Van Gogh at auction."

Witmer goes on to explain that "until the early 1980s, it used to be possible, when we advised a company to expand through acquisitions, to identify attractive publishing properties, cultivate them, serve as a catalyst and enter into an exclusive dialogue with a potential seller. That's changed and now most companies of a reasonable size ($25 million plus) will use a professional adviser and sell on a competitive basis. Competition is a key factor in why prices have gone up so dramatically."

Another factor pointed out by many analysts is the scarcity element. There simply are far fewer companies of any scale left to buy, and if an extraordinary opportunity comes along—a Chatto, Bodley Head and Cape, a Doubleday or Bowker or Harper & Row—potential buyers will be lining up. As Martin Levin, who spent many years buying publishing companies for Times Mirror puts it, "If you take a really beautiful, flawless diamond, one carat isn't just one carat. It's worth more than anybody else's diamond, and that is the key ingredient in the pricing of a Harper & Row." And of course, the price paid for one extraordinary diamond begins to look a lot less outrageous when the next precious stone comes on the block. Levin continues, "The publishing industry in America has consistently undervalued itself. It's been perceived as a high risk business, but in fact so many companies make a great deal of their money through the backlist, where risk isn't a factor."

The concept of "fit" also plays a large role in many purchases on a grand and not-so-grand scale. David Amerman of Moseley Associates, who formerly was a group vice-president of Prentice Hall, reckons that for Gulf + Western's strategic publishing plan, "Prentice Hall had a remarkable fit. It was almost perfect. In each group that they put together after the acquisition they were able to attain a critical mass that gave them enormous clout." And as Donald Schaefer, currently CEO of International Thomson Publishing, but until the Gulf + Western takeover, CEO of Prentice Hall, points out, those divisions or lists where fit is not so consonant with the acquirer's strategic plan can quickly be sold off to help finance the purchase of what is desired. "Almost immediately, Gulf + Western let it be known that they were going to sell off parts of Prentice Hall. For example, they sold Deltak for $100 million, which meant that the purchase price of PH was soon $610 million rather than $710 million. Furthermore, a purchaser can combine divisions and do other things to make the price less costly."

Large savings can be achieved through combining sales and marketing operations, rationalizing warehouse and computer facilities, consolidating paper procurement and, to a lesser extent, streamlining production and design facilities. Middle-size independent publishers don't benefit from such economies of scale; nor do they generally enjoy the flexibility of small, owner-managed companies. For many medium-size houses, sources for long-term investment to finance growth are inadequate or, as Walter Minton pointed out, the specter of debt simply looms too large.

Some publishers feel that the growth of larger publishing organisms must be considered in light of developments in the retail field over the past 30 years. Ron Busch, whose paperback career has included stints at Bantam, Ballantine and Pocket Books, recalls that "when I started at Bantam in 1957, we didn't have a single customer who represented more than 3% of our total volume. Then wholesalers began to acquire companies all round the country, Ingram became a powerful force, 15 years ago Walden and Dalton came on the scene, followed by Crown and Barnes & Noble a few years later, and you now have huge wholesale and retail operations. Publishers had to respond somehow." Penguin's Peter Mayer agrees. "Few people ask the question—isn't it appropriate and necessary that power centers in retailing be confronted by power centers in publishing?" Mayer also points out that "large, medium-size and even small companies need a modern infrastructure. Many traditional publishers, especially those with editorial backgrounds, haven't made the effort to know the back-end of the business. So another reason for size in publishing is that one can't maximize sales with primitive computer services or warehousing operations."

The Global Effect

Two other elements that have emerged in the 1980s need to be highlighted. The publishing business is going global. The woeful state of the dollar combined with limited possibilities in their own backyards have led a number of foreign publishers to start cultivating American gardens. In 1986 buying a Doubleday or an NAL or a W. H. Freeman was not quite so expensive if German marks or British pounds were being used. The traditional international outlook of European publishers and the enormous American domestic market have combined to fuel such transatlantic crossings. And more and more American publishers are waking up to the fact that the information flow can go in both directions, and that "fit" to be extraordinary doesn't have to be made with domestic materials. Random House, Knopf and Pantheon fit exceedingly well with Chatto, Bodley Head and Cape.

The second element is the recognition on the part of a number of corporations, which historically were not significant investors in publishing, that excellent financial rewards can be obtained through the book business. International Thomson has turned from oil to information services and books; and the Newhouse family and Rupert Murdoch have both decided that books, as much as other forms of media, are worth investing in. And of course, such investments are helped along by the decline in interest rates in America and the concurrent equity price increase. Buyers have been able to pay more in part because of the reduced cost of funds.

Finally, in Reagan's America, antitrust barriers that might have previously exercised a restraining influence on concentration—that were brought into play, for example, when CBS wanted to buy Fawcett in the 1970s—are no longer the fashion of the day. Under Reaganomics, big is beautiful, whatever the long-term consequences may be, and the book publishing industry consolidation is consistent with that in businesses across the American economic map.

People get used to a situation and come to accept it as the norm, so that the vociferous protests of the '70s, when companies like Houghton Mifflin and McGraw-Hill were the apples in potential acquirers' eyes, have not been so publicly voiced when a Prentice Hall or a Harper & Row or a Harcourt Brace has been put into play. And the sheer tempo of recent mergers increases the pressure on many companies to go along with the trend.

Although owners who sell—like Ted Cross or Walter Minton or Nelson Doubleday—may regret losing control of their companies, such transactions bring to them a very great deal of money these days. Similarly, for many top executives or as in the case of Harper & Row, for the employees themselves, the pill can be sweetened by golden parachutes, tin parachutes and the like. Once the sugar coating dissolves, though, it can still taste remarkably bitter.

Friendly Fire

What exactly happens when a publishing company changes hands—how can one anatomize the steps involved and the roles of buyer, seller and those who help the whole process along? According to John Suhler, most transactions in the book publishing world are "friendly," with the seller wanting to sell and the buyer wanting to buy. He feels that in book publishing it is an exception to have a takeover, i.e., an "unfriendly" action.

For some people, though, the line between the two gets rather blurred, depending on who is doing the talking. Thus, Gulf + Western may have regarded their bid for Prentice Hall as friendly, but none of the PH employees who were around at the time of the merger and were interviewed for this article shared that viewpoint.

A sale can begin in several ways. An organization such as International Thomson can develop very detailed files on companies like Warren, Gorham & Lamont that they would be interested in purchasing for strategic growth. They can compile such a databank on their own or with the help of investment advisers and can then make the first move and approach a tar-

'People see the values being assigned to similar companies in the marketplace and decide it's time to cash in. Once somebody crosses the line to sell, a real momentum builds up'

JOHN SUHLER

geted company either directly or through the intermediary of a banker or adviser. On the other hand, an owner like Walter Minton may decide it's time to sell and start making approaches to likely purchasers either on his own or through an intermediary.

Sometimes it's a combination of the two. Peter Jovanovich recalls that his firm "really wanted to buy the Holt publishing operation from CBS. We targeted it and started working on it two years prior to the acquisition. My father wrote to the then head of CBS, Thomas Wyman, expressing his interest. One of our v-p's, Ralph Caulo, did a detailed analysis of the operation. So when the new head of CBS, Laurence Tisch, called us, we were completely ready, and the speed of the acquisition demonstrates that. My father met Tisch on a Thursday and we signed the definitive agreement—about 100 pages—the following Friday."

Often, though, transactions are not so quick, cool and calm, even if they have been strategically targeted by the acquirer for a very long time. A company like Harper & Row may declare to the public that it intends to remain an independent entity, and it may enact certain protective measures to try to ensure that that happens. But no poison pill or golden parachute or staggered directors scheme is foolproof, and sometimes an attempt at enacting such measures can, as it turned out for Harper & Row, be a dangerous gamble in itself. It may be a red flag to those who see the vulnerability of the company and decide to make a bid before any further protective barriers are put in place.

David Amerman recalls once hearing someone quip, "The only difference between a friendly and a hostile takeover is about six months." Although Ted Cross's bid was "friendly," it put Harper & Row into play and a tender offer for the company's shares—an offer that couldn't be refused—was the eventual result. According to Don Schaefer, "Once a tender offer appears, for all intents and purposes a company is sold. There is no anti-takeover measure that will protect a public company from a preemptive offer."

'If you look at Rupert Murdoch's holdings, the Harper & Row purchase, although expensive in book publishing terms, is not really all that large. I suppose it's similar to the way a Japanese insurance company might value a Van Gogh at auction'

RICHARD WITMER

Shareholder Responsibility

Brooks Thomas, who resigned as Harper & Row CEO last month, recalls the measures his house tried to take to protect itself. Approaches had been made by investment bankers to Harper directors for some time. "We staggered the terms of the board of directors and last December enacted a 'poison pill.' In January we decided to ask for a reclassification of the stock with unequal voting rights." It was that decision, of course, that triggered the sale.

Thomas continued, "The directors of a public company have an obligation to the shareholders. Recent legal cases have said forcefully to directors that they must run companies for the benefit of stockholders even if at the expense of our other constituencies, for example, employees (although Harper directors in fact controlled 17% of the stock and employees, through their Stock Plan, held 29% of the voting power), authors, readers and maybe even the culture at large. Our job was to run the company for the benefit of all those constituencies, but recently the law has said that the shareholding constituency is the only one you can really care about.

"Cross's move was not totally unexpected. We knew he was there and that he might view the intended reclassification as taking the company out of play. We knew it might push him off the fence, but we also knew that others who were accumulating stock were definitely hostile and we had been monitoring the buying of our stock very carefully. We decided to take a calculated risk. Of course, with hindsight, maybe we shouldn't have gone for two classes of stock, but even if we hadn't, would that have made a difference? That's a question I'll be asking myself for the rest of my life."

One closely postioned observer recalls that "Ted Cross bought the shares in 1983–84 when the price was $16–$17 and is a very shrewd investor. He knew that the company was worth more than his initial offer of $34." The Cross offer came in on a Monday and was discussed by the Harper board the next day. Harcourt Brace Jovanovich put in their $50 offer the following day. When that came in, the situation grew much more tense and the invisible "not for sale" sign began to be taken down. According to some Harper insiders, the management did consider attempting a leveraged buyout when the offers started coming in, but Brook Thomas feels, "We couldn't have earned enough during the next two to three years to support a similar price on the stock market on our own. Remember that on March 10, the day the Cross offer was made public, our shares were selling for $25. Rupert Murdoch offered $65. Frankly, with hindsight, I think we could have said no to HBJ, but when it became evident that people were willing to pay even more, we saw the writing on the wall." After the HBJ offer, Thomas appointed an outside committee headed by Winthrop Knowlton to explore the possibilities and conduct the negotiations.

Harper insiders describe that there was a lot of coming and going of potential suitors and Brooks Thomas has confirmed that some, besides Murdoch, were from abroad. Financial information had to be provided, staff began asking questions and it was clear that most of those courting the company were interested in the least

'Of course, with hindsight, maybe we shouldn't have gone for two classes of stock, but even if we hadn't, would that have made a difference? That's a question I'll be asking myself for the rest of my life'

BROOKS THOMAS

risky areas of its business—that is, everything but the trade division. Rupert Murdoch was the only high-paying suitor who claimed to want the whole operation, and he was the highest bidder as well. The board of directors could have sold the company piecemeal, but wanted to attempt to keep it together as best they could. According to Brooks Thomas, "Rupert Murdoch was physically present for the negotiations, and the committee chaired by Knowlton only had two or three meetings with him and Ian Chapman of Collins (42% of which is owned by Rupert Murdoch). One week elapsed between Murdoch's first expression of interest and the handshake on the deal."

While the negotiations were going on, Thomas saw his role as "keeping the place going. You have to talk to people, to walk around, show yourself, to try to be reassuring and keep the ship afloat. You try to answer questions that you don't know the answers to." Once the Murdoch bid was recommended for acceptance, the official tender offer for $65 a share was made on April 2 by a company called "Harper Acquisition Inc." that had been set up expressly to facilitate the deal. The offer was to expire April 29, and if 51% of the shares were tendered, Murdoch would control the management, but he would have to get at least 90% to be in complete control and avoid a shareholders' meeting that would delay the transfer of ownership by four to six weeks. As it turned out, Murdoch got 96% of the shares by the time the tender offer expired. Brooks Thomas's resignation was announced two weeks later, and Ian Chapman and George Craig of William Collins were put in charge.

The Harper & Row Fit

Many observers feel that the attraction of Harper & Row for Rupert Murdoch lay in its trade list, where links could be forged with his other media companies and where a very special synergy could be found with Collins. Murdoch had tried unsuccessfully several years ago to gain control of Collins, and some observers feel that the Harper purchase will make it more likely for him to obtain control of the British publishing house in future, especially since Collins was unsuccessful in its attempt to enter the American market on its own some years ago.

Certainly the official pronouncements from the beginning envisaged a major managerial role for Collins, although one Harper insider claims that the relationship between Collins and Rupert Murdoch with respect to this particular transaction has yet to be entirely worked out, and goes on to observe that Murdoch will probably pay a lot more attention—welcome or otherwise—to Collins in future. Brooks Thomas confirms that from the initial handshake on, about three or four Collins people, as well as another eight or so from News America, started to make frequent visits to Harper headquarters, collecting a great deal of information about operations, posing legal and accounting questions and interviewing key people throughout the company.

For some Harper people, the atmosphere within the company has been curiously calm, whereas others find it terrible, with meeting after meeting punctuated by question marks in between. One insider describes it as "the calm before the storm. Waves of worry come and go and people are trying to find alternatives in a quiet way. Of course, the parachute of our employee stock plan helps. It's based on salary level and age, and I'd estimate that someone who is 35 years old, earning $30,000 and has been with the company for five years would get between $80,000–$90,000 on the pension plan alone." News America has agreed to carry on the Harper termination policy, vacation days scheme and benefits plan and will after this year either retain the pension plan or provide an equivalent.

What, though, will Murdoch do with the company itself? Some insiders feel that having paid 55 times earnings, and bearing in mind the fact that Collins has never been particularly successful with professional or technical publishing, he will move to sell the professional and educational divisions of Harper & Row as quickly as possible, although they can't all be

TABLE 2

ESTIMATED POSITIONS OF LEADING U.S. BOOK PUBLISHERS 1986

Trade	College	El-hi
* 1. Advance Publications (Newhouse family)	* 1. Gulf + Western	* 1. Gulf + Western
* 2. Gulf + Western	* 2. McGraw-Hill	* 2. Harcourt Brace Jovanovich
* 3. Harper & Row	* 3. Harcourt Brace Jovanovich	* 3. Time Inc.
4. Crown Publishers	* 4. Int'l. Thomson Organisation	4. Houghton Mifflin
* 5. Bertelsmann	* 5. John Wiley & Sons	* 5. Macmillan
* 6. MCA	6. Addison-Wesley	* 6. Scholastic
7. Hearst	7. Dow Jones	7. McGraw-Hill
* 8. Macmillan	8. Houghton Mifflin	8. Raytheon
9. Houghton Mifflin	* 9. Macmillan	9. Addison-Wesley
10. Time Inc.	*10. Time Inc.	
*11. Pearson, plc (Penguin)		

Courtesy of Brown Brothers Harriman

part of the same transactions for tax reasons. Exactly 51% of Harper's revenue comes from trade books, and if the other 49% were lopped off, Murdoch could probably get about $200 million, making the Harper purchase considerably less expensive.

Brooks Thomas has said that he tried to foster in Harper staff "an open mind about change and a positive attitude," but many insiders feel that even the trade division will undergo a cultural change, that the books will become more commercial and less literary. Oddly enough, Brooks Thomas has said that "there was less of an inundation of questions from our trade authors than we had feared. Most of them seem to feel that nothing will change."

What is so interesting about the buying and selling of companies is that the same tale told by different tellers is of course often not the same tale at all. Thus, when Ted Cross was asked about why he made his offer for Harper in the first place, he commented, "After Warren, Gorham & Lamont, my associates and I had bought *Investment Dealer's Digest* and sold it for a considerable sum. I wanted to embark on a challenging new career in general book publishing and had the resources to do it. The First National Bank of Boston agreed to lend me $180 million to finance the purchase. I know people say I simply wanted to put the company back into play, but that's not true. If we hadn't been serious about buying it, a bank like the First National wouldn't have agreed to lend that money in the first place.

"People on Wall Street said to me that if I increased the offer to $40 a share we'd take the company in a cloud of dust. I had plans to bring in a few new people and take a part of Harper in the Warren, Gorham & Lamont direction. We would have built up the professional, legal and database publishing—I would have constructed a database from Lippincott's medical books. When HBJ made their $50 bid, I was stunned, although it would have made them pre-eminent in medical publishing, would have improved their college situation and would have been a defensive tactic to accumulate debt to ward off any takeovers themselves."

Setting the Price

When a company is put into play, how, in fact, is the magic dollar value assigned to it by the potential acquirer arrived at? What do all of these meetings between buyer and seller actually look at? Ted Cross feels that "there are in fact two markets for publishing companies. One is based on economic forces, the New York Stock Exchange market of conventional buyers who are driven by the bottom line of profit and loss. The other market is made on the stage at Sotheby's, where publishing valuations are set instead by dreams, egos, romance and inherent scarcity. Harper & Row turned out to be a classic example of a Sotheby's auction of a fine painting." Dreams and romance, as evidenced by Table 3, have had an extraordinary effect upon the price-earnings ratio average. Richard Witmer agrees, "A company that is led by a strong CEO can be influenced to a large degree by passion—if you want a company badly enough in your portfolio, who's to say what it's worth? "

In acting for a prospective buyer in valuing a publishing company, Witmer says, "We believe it is important to start with the product and not with the financial details. The quality of the list is the foremost consideration. If there is high editorial quality and a demand for that company's books, then we feel the financial performance can be enhanced. If our client isn't familiar with that particular field then, for example, we find people who study the list for us and we also do market research. For professional or business books, we sometimes do surveys based on questionnaires. If it's a college or elhi company, then of course we look at demographics and adoptions.

"If the list is strong and there's good product in the pipeline, we then do a financial analysis of the company as a freestanding entity and as part of our client's organization. We do a basic discounted cash flow analysis which brings the projected cash flows back to present value. We look over a five- and 10-year period, but this first evaluation assumes a debt-free situation."

J. Kendrick Noble, publishing analyst at Paine Webber, explains in greater detail that the cash flow analysis involves "looking at the probable pre-tax income of the company that will be generated over a period of years, adjusted to exclude interest payments, depreciation and amortization as valued at present. You take a long stream of income and apply a risk discount factor which again is based on a certain number of years. If the company is dominant or unique in its field, it might be looked at over a 10-year period; if it is well established, then it would be a seven- or eight-year factor; if uncertain but not in trouble, then perhaps five years. If the risk discount rate is at 10% and you think the company will grow at a rate of 10%, that approach equals the number of years times last year's pretax income or the number of years times last year's income after tax, and that gives you your figure."

The Process of Due Diligence

But the analysis does not stop there. Witmer continues, "We look for potential savings in distribution and marketing, but not in editorial. In my opinion, there's often a misunderstanding about the editorial sector. You usually in fact plan to increase investment in that area, since you want to maintain the relationships with the firm's successful authors and to create new product. Your financial projections are a function of a lot of things—the company's management and what you intend to do with it, the product in the pipeline, the company's book pricing policy, the nature of their royalty agreements, hidden assets like unused real estate, excess pension assets and cash, the backlist and the competitive environment in the marketplace for the product. You also look at how the company is capitalized and whether they have any debt. Part of the analysis is of course who else we think will be bidding for the publishing house and how high we reckon they are willing to go, and what similar transactions have gone for in the recent past.

"If the company for sale is private, then after you qualify as a 'serious' bidder with them, they will give you access to additional information. They might give you a day or two to interview management, and you go back and fine-tune your analysis in light of due diligence and the bid date by which you must submit your definitive offer. You then put it into a letter, setting forth all the conditions of your offer. Anything can happen after that. Generally, you turn out to be one of a limited number of serious contenders and may be given an opportunity to improve your offer if you wish."

About the only governmental brake that can be applied to a prospective merger falls under the Hart, Scott, Rodino amendment to the Clayton Anti-Trust Act. If one

'As quality publishers, Scribners and Atheneum believe that editorial independence is essential and that [merging] is the preferable alternative to the current tendency in publishing toward takeovers by conglomerates'

CHARLES SCRIBNER JR.
in 1978, six years before selling to Macmillan

of the two companies involved has assets or net sales of $100 million or more, and the other company involved has assets or net sales of $10 million or more, then pre-notification of the intended merger must be filed with the Justice Department. A waiting period must then elapse during which the government can investigate the implications of the transaction as it impinges on competition in the marketplace. None of the megamergers that has taken place recently has caused the government to have second thoughts.

According to Richard Witmer, "If the company under consideration is public, then a lot of time is devoted to working out how to reduce deal risk. An acquirer's various options include accumulating stock in the marketplace, buying a substantial block of shares, negotiating a merger agreement or effecting a tender offer or some combination of the above. What route you take depends on the particular circumstances, including your assessment of likely competition." Unfortunately, some observers have commented that not all routes that have been taken to acquire companies have been entirely straight and narrow. Reportedly, one company trying to orchestrate an acquisition tapped into a board member of the targeted house for inside information that helped them in assessing exactly how much to bid—an action that was rather dubious legally. Companies have also been known to approach investment or consulting firms that have been engaged by a targeted house in the past to get detailed financial information that would put them on the inside track in negotiations.

Hindsight Wisdom

Even when all parties agree that their particular publishing marriage has been made in heaven, things often don't work out quite as they had planned. In 1978, Charles Scribner's Sons and Atheneum Publishers merged. At the time, Charles Scribner Jr. said, "We are both medium-size publishers. This will make us a larger medium-size publisher and still allow us to keep our identities." In the statement released by both companies announcing the merger, the publishers said: "As quality publishers, Scribners and Atheneum believe that editorial independence is essential and that this decision is the preferable alternative to the current tendency in publishing toward takeovers by conglomerates" (*PW*, Aug. 7, 1978). However, less than six years later, Macmillan was buying those self-same merged Scribner Book Companies, although Charles Scribner Jr. at that time again hailed this development as "a fabulous move." By the end of last year though, Macmillan's general books division, into which the Scribner Book Companies had fit, was announcing that its adult hardcover new publishing program would be reduced by 35% in 1987 along with a reduction of 20 jobs. What happened along the way?

One observer looks back to 1978 and the reasons for the original merger. "Atheneum had had a run of bad luck in their new publishing program and they didn't have a substantial backlist to sustain them. They ran up a great deal of debt and owed a lot of money to Scribner, who did their warehousing. The merger took place because Scribner wanted to grow through building a larger company and Atheneum wanted to do something to relieve their financial situation, but this in fact proved to be a drain on Scribner's own health."

Despite Charles Scribner's personal commitment to publishing, problems started to multiply when the families owning the company were offered a great deal of money for the Scribner warehouse in New Jersey, which had acted as a distribution center for many different publishers. The families decided to take the path of least resistance and at the same time entered into what they thought would be an efficient, cost-cutting arrangement with Arcata, the printers, to go into a new facility in Tennessee. Unfortunately, the timing proved to be more than a little ill-advised.

The construction of the new warehouse and ramifications of the move meant that it was impossible to get the books out to the bookshops, and worse still, the company missed an entire sales season. As Peter Mayer pointed out earlier,

TABLE 3

MARKET DATA FOR SELECTED BOOK PUBLISHING COMPANIES

Company	Market Value ($ millions)	Price/ Earnings on 3/30/82	Price/ Earnings on 6/2/87	Price/ Revenues	Price/ Book
Addison-Wesley	154.8	8.4x	21.9x	1.0x	2.8x
Harcourt Brace Jovanovich	2,182.8	5.2	38.7	2.1	4.3
Harper & Row	283.6	5.8	54.4	1.3	4.0
Houghton Mifflin	537.8	6.2	23.8	1.7	3.7
Macmillan	1,345.0	12.9	25.6	1.6	4.6
McGraw-Hill	3,207.8	12.7	21.6	2.0	3.7
John Wiley & Sons	162.7	6.2	17.5	0.8	1.7
Average		8.2x	29.1x	1.5x	3.5x

Based on most recent end-of-period financial statements; comparison of price-to-earnings ratios in columns two and three show last 12 months' earnings from continuing operations as per most recent end-of-period financial statements.

Courtesy of Brown Brothers Harriman

getting the back-end operation of a publishing company right is these days crucial to continued success, and the difficulties of the move to Tennessee bled the resources of the company.

Early in 1984, Marvin Brown and Franklyn Rodgers, who were among the senior executives of the company, left for other jobs, and although financial health was being restored, Scribner people took their departures as a sign that further change was afoot. Rumors circulated within the house and a number of other executives decided to place their futures elsewhere. People within the company felt that a sale would take place but, surprisingly, word of the negotiations that were in fact going on between Macmillan and the Scribner Book Companies did not leak out. Reportedly, the two families—the Schieffelins and Scribners—who controlled the company chose not to go to outside investment advisers for help. Since the owners seemed to value privacy above market-driven considerations, they approached Macmillan themselves and there was no competitive bidding. Many observers feel, therefore, that when the deal was consummated for $15 million, that figure did not adequately represent the true value of the business.

Before the sale was announced internally, Macmillan had begun to take over the company's warehousing and distribution, so employees sensed that a change in ownership was not far behind. Just before it was made public, employees were informed with the usual assurances that nothing of substance would change and that no staff member need worry. One employee at the time recalls that "we were appalled, once news began to leak out, at the denials that were made. We felt that people on the outside wouldn't believe anything coming from this house again. And in retrospect, the Scribner family were like most people who sell something—they thought that they would be able to benefit from lots of Macmillan investment capital and that they would still be able to keep the company as usual.

"Nelson Doubleday no doubt thought the same way about the sale of his company. It comes as an enormous shock to most private family owners to discover that changing hands usually means changing who is in the driver's seat." Walter Minton knows this all too well from his own experience in selling Putnam to MCA. "Anybody who sells and expects no change in a short time is usually out. If you have run your own company, you think you can tell others what they should buy or do—but you can't."

One former Scribner employee takes up the story: "Things started to happen instantly. The day after we were told of the sale, someone from Macmillan personnel came to give us a session on our retirement plans. We were shown a film about Macmillan Publishing and sat there dazed, realizing that the culture of our company just would not be the same." The sale was effective on June 1, 1984, and throughout the early part of the summer, people had the feeling that they were drifting along, waiting for the larger waves of change to follow. One development that took place very early on was the introduction of a kind of bureaucracy that the company had previously never labored under—suddenly form-filling and three- and five-year plans were the fashion of the day.

Good News/Bad News

As Richard Witmer pointed out when describing how a firm is financially analyzed, hidden assets often prove to be rather valuable. Thus, when the Scribner pension plan was changed as a result of the Macmillan purchase, years of service at Scribner suddenly didn't count towards retirement (this is often the case). Two weeks severance pay for every year of employment was halved and the Scribner tradition of closing early on Friday afternoons was stopped instantly. On the other hand, although contracts were changed, there was no difference of any substance between the old and the new, and advances to authors—partly as a result of Macmillan capital—were generous.

Perhaps the most visible sign of change came in August 1984 when it was announced that in a separate deal the Scribner family was selling the famous Fifth Avenue building that housed its offices and bookstore to the Duane Reade Drug Company. After the sale of the building, the store itself was sold to Rizzoli, since without the subsidized cheap rent that came from owning the building, the family found that the finances of their bookselling operation were rather altered. The new rent also proved to be unattractive to Macmillan and so the offices of the merged book company had to relocate as well. Unfortunately, the new premises that Macmillan had contracted for Scribner were not quite ready when the move was due to occur, but it went ahead anyway, prematurely, in order for Macmillan to avoid paying rent on two different buildings. One former employee describes those months immediately after the move in autumn 1984 as "a totally demoralizing experience. Nothing seemed to work—electricity, plumbing, heating weren't ready for us—and the worst thing of all was the phones. Just after the move, we had a book that was hitting the bestseller list and our phones didn't work. Can you imagine a publishing house with no phones? It was a nightmare."

During the course of the following year, the sales forces of the two firms were combined and the children's book imprints of the companies were folded into one group. The personnel and financial departments were controlled by Macmillan people. When the shakeup in adult trade publishing at Macmillan came in the autumn of 1986, many observers, given the course of the merged companies' history up until then, were not entirely surprised. As one publisher put it, "Scribner and Atheneum had some marvelous assets. Individual parts, folded into Macmillan, were worth a great deal. The children's books gained through the acquisition in effect doubled Macmillan's juvenile sales; the paperback line of classics by Hemingway, Fitzgerald and the like were absorbed into Collier; the Scribner college department was absorbed into the Macmillan equivalent, as were some of the reference books. What was left was the highest-risk publishing—the frontlist at Scribner and Atheneum. It would have taken at least three years and considerable investment for that side of the business to prosper again." Once the more digestible parts of Scribner and Atheneum had been sandwiched into the big Mac, given the history of the previous few years and the risk of investment in trade publishing, it is not so very surprising that the brakes were finally applied to the adult hardcover sector.

The second installment, to appear next week, analyzes the moves and changes that take place soon after a merger by focusing on recent takeovers, i.e., Simon & Schuster/Prentice Hall, Bertelsmann/Doubleday and Penguin/NAL, as well as the changes at Random House. □

July 3, 10, 17, 1987 Not Filmed